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UNCLAS SECTION 01 OF 03 LAGOS 000415

SENSITIVE
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TAGS: [ENRG](#) [EINV](#) [EFIN](#) [PGOV](#) [NI](#)
SUBJECT: NIGERIA: CONOCOPHILLIPS POWER PLANT POINTS TO
WIDER ISSUES IN ELECTRICITY SECTOR

REF: A. LAGOS 318
[1](#)B. LAGOS 302
[1](#)C. LAGOS 143

SENSITIVE BUT UNCLASSIFIED BUSINESS PROPRIETARY INFORMATION;
HANDLE ACCORDINGLY

[1](#)1. (SBU) Summary: Expansion of a 480 megawatt power plant in Delta State, which would double the plant's capacity, has stalled because the state power company consistently fails to make payments while demanding the power supply contract be renegotiated. ConocoPhillips, part owner of the plant in a consortium with Agip and the Nigerian National Petroleum Corporation (NNPC), will not invest in the expansion until it is paid USD 135 million owed to it for power supplied to the national grid, and until the power supply contract dispute is settled. Furthermore, backsliding on the current power contract has made ConocoPhillips less likely to accept GON payment guarantees in future power projects. Compared to other emerging market countries, with functioning transmission and distribution grids, that generate 10-20 percent of their electricity from IPPs, Nigeria plans to generate 40 percent from IPPs. Instead, Nigeria might be better served by focusing its efforts on stabilizing the power grid, reconditioning existing government-owned power plants, bringing new government-owned plants on-line and coming to some finality about the status of the transmission and distribution companies. Alternately, the GON could push for off-grid generation, transmission, and distribution projects as stop gap measures to provide power to the industrial customers who generate sufficient income to pay for electricity without GON assistance. End Summary.

Payment Problems Hamper Delta State Power Plant

[1](#)2. (SBU) The Kwale-Okpai Independent Power Plant is located in Delta State and is a combined cycle, gas fired plant that produces 480 megawatts of electricity, or 15-20 percent of Nigeria's total electricity supply. It came on-line in March 2005 and is owned by the joint venture consortium that includes Nigerian Agip Oil Company, ConocoPhillips and the Nigerian National Petroleum Corporation (NNPC). (Note: The joint venture is primarily an oil production joint venture with Agip as the operating partner and ConocoPhillips and NNPC as equity partners. End Note.) The joint venture has a power purchase agreement (PPA) with the Power Holding Company of Nigeria (PHCN) for PHCN to off-take all the electricity

produced at the plant. Natural gas to fuel the plant is supplied from the joint venture's nearby fields.

13. (SBU) Construction of a second phase to the plant, which would add an additional 480 megawatts and was scheduled to commence in 2007, has stalled. According to local press reports and conversations with executives from ConocoPhillips neither Agip nor ConocoPhillips have been paid in full for electricity produced by phase one of the plant. A senior ConocoPhillips executive in Nigeria told Energyoff that his company is owed USD 135 million by PHCN, while Agip, which owns a larger share of the joint venture, is reportedly owed a proportionally larger sum (Ref A). Before phase one of the power plant was constructed, ConocoPhillips and Agip understood that payment securitization would be essential for the deal to succeed. Accordingly, the PPA for phase one includes an agreement by NNPC, as a state-owned company, to securitize PHCN payments by forgoing its portion of the profits from the power plant if PHCN failed to make payments to the joint venture, thus giving ConocoPhillips and Agip a superior claim on the cash flow from the plant. However, the ConocoPhillips executive said PHCN consistently fails to make timely payments and consistently under pays what it owes, while NNPC has proven adept at finding loopholes and other reasons not to make good on its promise to make the other joint venture partners whole.

14. (SBU) In addition to not making payments, PHCN is demanding the current PPA for phase one be renegotiated. ConocoPhillips is open to the idea if it can get a guarantee that the negotiations will settle the dispute once and for

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all and if the company is paid all it is owed from phase one. However, the company refuses to even consider investing in phase two until the issues surrounding phase one are settled. Additionally, ConocoPhillips will be reluctant to accept payment securitization from any GON entity in future electricity projects. ConocoPhillips estimates it would need to invest USD 500 million for phase two, with that amount increasing if the project is further delayed. According to the local press, negotiations with Agip on phase two have broken down as the dispute over the current PPA drags on.

ConocoPhillips Uses Power Generation for Oil Access

15. (SBU) ConocoPhillips power generation business unit is expressly designed to assist its upstream exploration and production unit gain access to oilfields and provide a ready market for its natural gas. ConocoPhillips expects nine to eleven percent return on power projects and fifteen percent on upstream oil and gas. While the company accepts lower rates of return in power generation, the company does not operate the unit as a "loss-leader". Okpai is not profitable for ConocoPhillips and its local executives will not go back to the company's headquarters and recommend additional investment in the Nigerian electricity sector until the problems surrounding the first phase of a Okpai are resolved.

Dilapidated Grid Raises Power Plant Operating Costs

16. (SBU) The ConocoPhillips executive also lamented the poor condition of Nigeria's electricity transmission network, saying power surges and grid outages have been problematic for the power plant, increasing operating costs and damaging some power generation equipment. (Note: Managers at AES Nigeria's Lagos IPP have told us that the unstable grid has caused equipment damage at their power plant as well. End Note.) Additionally, he described the structure of Nigeria's transmission and distribution companies as "baffling", noting anecdotally that in a recent meeting with the Minister of State for Gas, the Minister himself admitted he didn't understand the structure of Nigeria's transmission and distribution sector. (Note: The GON "unbundled" the state

owned power company into six generation, one transmission, and eleven distribution companies under a single holding company called Power Holding Company of Nigeria (PHCN). The aim was to eventually privatize the eighteen companies, but that effort stalled after the new Presidential administration came to power in 2007. End Note.)

Comment

17. (SBU) We probably should not get too worked up over the fact that Nigeria is seeking better terms on contracts. As noted in a 2006 Stanford University study of independent power projects built in emerging market countries in the 1990's and as reflected in both the AES and ConocoPhillips cases, investors are not always adverse to renegotiating power contracts. Power purchase agreements signed before a complex IPP has been built are likely to require some adjustment after the project is completed. The Stanford study notes the inherent tension between the short term goal of immediate investment in IPPs, which demands some policy and regulatory consistency (but not necessarily ideal policies or regulations), and the long term goal of electricity sector reform, which is often an iterative process that evolves over time in fits and starts. Nigeria is at the beginning of what looks to be a long and probably contentious process of reforming its electricity sector. While laudable, that may in fact hinder significant foreign IPP investment in the near term.

18. (SBU) Oil company-lead IPPs further complicate the picture. Clearly, the primary goal of these projects is access to oil reserves and not power generation, company claims about corporate social responsibility notwithstanding. It is hard to see what is going on behind the scenes in these power projects, but we wonder if the dynamic

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of oil is not warping the negotiations and sending the GON the wrong signals about how to deal with IPP investors. Given their quest for access to Nigeria's oil reserves and their long experience dealing with the GON, oil companies have been far more accommodating to the vagaries and whims of the GON than pure-play, foreign IPP investors are likely to be. In any case, elaborate power purchase agreements, sovereign risk guarantees, and payment securitization schemes may not be enough to attract sufficient numbers of IPP investors to Nigeria if the existing electricity sector is in a state of collapse and fuel supplies are sporadic and vulnerable to militant attack. It's simply too risky for the anticipated returns. Instead, Nigeria might be better served by focusing its efforts on stabilizing the transmission and distribution grid, reconditioning existing government-owned power plants, bringing new government-owned plants on-line and coming to some finality about the status of the transmission and distribution companies. Alternately, the GON could push for off-grid generation, transmission, and distribution projects as stop gap measures to provide power to the industrial customers who generate sufficient income to pay for electricity without GON assistance.

19. (SBU) Worldwide, an emerging market IPP boom in the 1990's ended in decidedly mixed results for foreign IPP investors. Initial investor enthusiasm in the early to mid 1990's was followed by a severe pullback in the IPP sector as the Asian financial crisis hit, returns to equity investors proved disappointing, and high profile IPPs in India and Pakistan went bust. We note Nigeria's IPP plan is ambitious even by the standards of the 1990s boom years, with an internal GE document showing 40 percent of planned, new generating capacity coming from IPPs. Other large emerging market countries like India, Indonesia, Brazil, Turkey limited IPPs to 10-20 percent of generating capacity and they added those IPPs to more or less functioning transmission and distribution grids. We are not aware of another large developing country that planned to use IPPs as the

cornerstone for building a functioning electrical grid. End
Comment.

[¶](#)10. (U) This cable cleared with Embassy Abuja.
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